



80a-1 et seq., as amended (the “1940 Act”), and has elected to be treated as a regulated investment company (RIC) under subchapter M, part I, of the Code.

### Background

During Year 1, Fund commenced its operations as a RIC with capital from other institutional investors (which were not registered under the 1940 Act). Shortly thereafter, Fund expected to create a public market for its shares. However, because of softness and, eventually, disruptions in the capital markets, Fund never offered its shares to the public.

During Year 2, as an alternative to a public offering, Fund raised capital from a new institutional investor (Investor). As a condition of investing in Fund, Investor required Fund to commit to conducting a tender offer within a specified period of time from the date of Investor’s investment in Fund, unless Fund was able to create a public market for its shares. Fund and Investor reached an agreement as a result of arm’s-length negotiations. As of Month 1, Fund had not conducted such a tender offer and has not been able to create a public market for its shares. However, Fund is contemplating another attempt at listing its shares on an established stock exchange and possibly offering its shares to the public. All of Fund’s current shareholders are institutional investors, other funds for institutional investors (which are not registered under the 1940 Act), and individuals, most of whom are affiliated with Fund’s investment advisor.

Because Fund’s ability to create a public market for its shares is uncertain, Fund intends to pursue alternative means of providing liquidity for its shareholders. However, the amount of cash available for this purpose is limited for two reasons. First, due to disruptions in the financial markets over the last year, Fund suffered significant losses, and Fund’s portfolio became less marketable. Second, Fund needs cash to pay dividends to meet the distribution requirements necessary to eliminate tax on its income. Despite its losses, Fund has continued to generate material amounts of investment company taxable income (as measured before the dividends paid deduction), in particular, because a large portion of its portfolio is held in debt. To continue to be taxed as a RIC and to not owe tax on its income, Fund understands that it must be treated as distributing its income in a manner that qualifies for the dividends paid deduction under section 561.

Consistent with its objective of being treated as distributing all of its income for purposes of the dividends paid deduction, Fund would like to maximize the amount of cash available for distribution to those shareholders desiring liquidity by minimizing the amount of cash distributed to those shareholders who do not want liquidity.

### Proposed Tender Offer

Under the Proposed Tender, only shareholders desiring liquidity would convert any portion of the value of their investment in Fund into cash. Under the Proposed Tender, Fund expects that some redemptions will be treated as dividends to shareholders. Such dividends, if not preferential, will reduce the amount that Fund is required to distribute to eliminate any tax on its income. Thus, Fund expects the Proposed Tender to maximize liquidity for those shareholders desiring liquidity while reducing the amount of cash distributed to those shareholders who do not currently want their shares converted to cash.

Under the Proposed Tender, all shareholders would be permitted to redeem all of their shares at their per-share net asset value (NAV), as determined on the closing date of the redemption. However, shareholders' redemptions would be subject to a cap on the total number of shares that can be redeemed by all tendering shareholders (Share Cap). If the aggregate number of shares exceeds the Share Cap, the shares accepted for tender from each shareholder would be reduced in proportion to the number of shares tendered by such shareholder relative to the number of shares tendered by all other shareholders. Fund expects the Share Cap to be about five percent of Fund's total number of shares outstanding.

Under the terms of the Proposed Tender, all shareholders would have exactly the same rights. Every shareholder would have an equal opportunity to redeem its shares. The NAV of the shares of those shareholders electing not to redeem would include the net income attributable to those shares for the entire year. All distributions would conform fully with the fiduciary duties that are owed to the redeeming shareholders. Such fiduciary duties require that redeeming shareholders be paid their per-share NAV for their shares redeemed. Thus, a shareholder would not receive more or less than what it was entitled to receive by reason of its shareholdings.

The sole purpose of the Proposed Tender is to provide maximum liquidity to shareholders while Fund is still being treated as fully distributing all of its income that would be subject to entity-level tax under Subchapter M of the Code. A shareholder would not be required to participate or not to participate in the Proposed Tender. Each shareholder of Fund would decide on its own whether to convert a portion of its investment in Fund to cash, whether to tender a certain number of shares in Fund, or whether to maintain its current investment in Fund. To the knowledge of Fund and its management, there will not be any agreements among any shareholders regarding any shareholder's participation in the Proposed Tender.

## LAW AND ANALYSIS

A corporation that has elected to be treated as a RIC under section 851 is taxed under Subchapter M, part I, of Chapter 1 of the Code. Under Subchapter M, the amount of a RIC's income subject to corporate taxation under section 852(b) of the Code is reduced by the RIC's dividends paid deduction.

Section 561(a)(1) of the Code defines a deduction for dividends paid to include the amount of dividends (as determined under section 562) paid during the taxable year.

Section 562(a) of the Code provides that, generally, the term "dividend" includes only dividends described in section 316. Section 562(c) provides that the amount of a distribution shall not be considered a dividend for purposes of computing the dividends paid deduction under section 561, unless such distribution is pro rata, with no preference to any share of stock compared with other shares of the same class, and with no preference to one class of stock as compared with another class except to the extent that the former is entitled (without reference to waivers of their rights by shareholders) to such preference.

Section 1.562-2(a) of the Income Tax Regulations imposes a limitation on the general rule that a corporation is entitled to a dividends paid deduction under section 561. Before a corporation may be entitled to a dividends paid deduction with respect to a distribution, every shareholder of the class of stock with respect to which the distribution is made must be treated the same as every other shareholder of that class, and no class of stock may be treated otherwise than in accordance with its dividend rights as a class. The existence of a preference is sufficient to prohibit the dividends paid deduction regardless of the fact (1) that such preference is authorized by all the shareholders of the corporation or (2) that the part of the distribution received by the shareholder benefitted by the preference is taxable to him as a dividend. A corporation will not be entitled to a deduction for dividends paid with respect to any distribution upon a class of stock if there is distributed to any shareholder of such class (in proportion to the number of shares held by him) more or less than his pro rata part of the distribution as compared with the distribution made to any other shareholder of the same class, or if there is distributed upon such class of stock more or less than the amount to which it is entitled as compared with any other class of stock.

Section 301 of the Code provides, generally and in part, that the amount of property distributed by a corporation to a shareholder with respect to its stock is the amount of money received and the fair market value of the property distributed. The portion of a distribution which is a dividend (as defined in section 316) must be included in income. The portion which is not a dividend is applied against and reduces the adjusted basis of the stock, and the amount in excess of basis is treated as gain from the sale or exchange of property.

Section 302(a) of the Code provides, in part, that a redemption of stock by a corporation will be treated as a distribution in part or full payment in exchange for the stock if the redemption: (1) is not essentially equivalent to a dividend within the meaning of section 302(b)(1); (2) is substantially disproportionate with respect to the shareholder within the meaning of section 302(b)(2); or (3) is in complete termination of all the shareholder's interest in the corporation within the meaning of section 302(b)(3). If section 302(a) does not apply to a redemption, the redemption will be treated as a distribution of property under section 301.

Section 316 of the Code defines the term "dividend" as any distribution of property made by a corporation to its shareholders (1) out of its earnings and profits accumulated after February 28, 1913, or (2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of earnings and profits at the time the distribution was made.

In New York Stocks, Inc. v. Commissioner, 164 F.2d 75 (2d Cir. 1947), the court concluded that the amounts distributed by an open-end investment company to stockholders redeeming shares in the investment company did not constitute preferential dividends within the meaning of section 27(h), the predecessor to section 562(c). The stockholders were allowed to redeem their shares at the net asset value of the stock series. Such net asset value was determined at the date of the stockholder's redemption and included the accrued income on the series for the taxable year. The court noted that open-end funds were in a unique position in that they stood ready to redeem shares for all shareholders at any time. Further, the court recognized that at the time a shareholder decides to sell, the shareholder receives its proportionate share of accrued net income up to the date of redemption. As such, those shareholders who retain their stock receive their earnings over the entire accrual period, and all shareholders have equal opportunity to redeem and are treated with impartiality. Thus, the court concluded, the distribution to the redeeming shareholder was not a preferential dividend. Similarly, in National Securities Series-Industrial Stock Series, National Securities and Research Corporation, Empire Trust Company, Trustee, et al. v. Commissioner, 13 T.C. 884 (1949), acq. 1950-1 C.B. 4, a case with similar facts, the Tax Court held that distributions of earnings on the redemption of shareholders' shares during the taxable year were not preferential dividends within the meaning of section 27(h), the predecessor to section 562(c).

In a prior decision, the Tax Court in United Artists Theatre Circuit, Inc. v. Commissioner, 1 T.C. 424, 430 (1943), acq. 1943 C.B. 23, after referring to the legislative history of the predecessor to section 562(c), concluded that:

These observations do not cover the precise issue before us, but they lend support to our conclusion that where a distribution is made available

in conformity with the rights of each stockholder, where no act of injustices to any shareholder is contemplated or perpetrated, where there is no suggestion of a tax avoidance scheme, and where each stockholder is treated with absolute impartiality, the distribution is not preferential within the meaning of the statute.

Certain principles set forth in the authorities cited above are equally relevant to a closed-end fund such as Fund. Fund's redemptions, like those of an open-end fund, will be made at the NAV of tendering shareholders' shares, including the allocable portion of net earnings of Fund up to the date of redemption. Every shareholder of Fund has an equal opportunity to redeem its shares of Fund, and those shareholders electing not to redeem their shares during any taxable year will be entitled to the net income allocable to their shares for the entire year. With respect to the amount distributed by Fund, there is a fiduciary duty to distribute the same amount, that is, the per-share NAV, to any shareholder proffering shares on a given date. As such, Fund will maintain the same equality and impartiality standards as the open-end funds described in the cases cited above. Thus, no shareholder will receive any more or less than what it was entitled to by reason of its share holdings of Fund. Under these circumstances, the holdings of the authorities cited above support the conclusion that, to the extent that Fund's distributions to its shareholders under the Proposed Tender are treated as dividends under section 316, such distributions should not be considered preferential within the meaning of section 562(c).

#### CONCLUSION

We conclude that distributions by Fund under the Proposed Tender will not be considered as preferential within the meaning of section 562(c) of the Code. Accordingly, to the extent that these distributions are considered as distributions subject to section 301 in the hands of shareholders of Fund and to the extent that these distributions also constitute dividends within the meaning of section 316, Fund will be entitled to deduct these amounts under section 561 and 852(b), provided Fund otherwise satisfies the conditions of these sections.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed regarding whether Fund qualifies as a RIC under Subchapter M of the Code; no opinion is expressed regarding the classification of any redemption proceeds with respect to redeeming shareholders; and no opinion is expressed concerning the amount of the distributions that will qualify as a dividend within the meaning of section 316 of the Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Susan Thompson Baker  
Susan Thompson Baker  
Senior Technician Reviewer, Branch 2  
Office of Associate Chief Counsel  
(Financial Institutions & Products)